



*Public Competition Assessment
17 May 2006*

**Queensland Rail and Babcock & Brown proposed acquisition of certain assets from
Australian Railroad Group**

Introduction

1. On 30 March 2006, the Australian Competition and Consumer Commission (the ACCC) announced that it had decided that the proposed acquisition of certain assets from Australian Railroad Group (ARG) by Queensland Rail (QR) and Babcock & Brown (B&B) would not have the effect, or be likely to have the effect, of substantially lessening competition in any market in contravention of section 50 of the Trade Practices Act 1974 (the Act).
2. The ACCC made its decision on the basis of the information provided by the parties and information arising from its market inquiries. This Public Competition Assessment outlines the basis on which the ACCC has reached its decision on the proposed transaction, subject to confidentiality considerations.

Public Competition Assessments

3. To provide an enhanced level of transparency and procedural fairness in its decision making process, the ACCC issues a Public Competition Assessment for all transaction proposals where:
 - a merger is rejected;
 - a merger is subject to enforceable undertakings;
 - the merger parties seek such disclosure; or
 - a merger is approved but raises important issues that the ACCC considers should be made public.
4. In this case, it is considered that the merger raises important issues that the ACCC considers should be made public.
5. By issuing Public Competition Assessments, the ACCC aims to provide the market with a better understanding of the ACCC's analysis of various markets and the associated merger and competition issues. It also alerts the market to the circumstances where the ACCC's assessment of the competition conditions in particular markets is changing, or likely to change, because of developments.
6. Each Public Competition Assessment is specific to the particular transaction under review by the ACCC. While some transaction proposals may involve the same or related markets,

7. it should not be assumed that the analysis and decision outlined in one Public Competition Assessment will be conclusive of the ACCC's view in respect of other transaction proposals, as each matter will be considered on its own merits.
8. Many of the ACCC's decisions will involve consideration of both non-confidential and confidential information provided by the merger parties and market participants. In order to maintain the confidentiality of particular information, Public Competition Assessments do not contain any confidential information or identify the sources of such information. While the ACCC aims to provide an appropriately detailed explanation of the basis for the ACCC decision, maintaining confidentiality will be the ACCC's paramount concern.

The parties

First acquirer (above rail assets): Queensland Rail

9. QR is fully integrated in passenger and freight, both above and below rail. QR employs around 13,700 people (including passenger services). QR's freight division contributes approximately \$1.15 billion in revenue.
10. QR is a statutory government owned corporation whose functions are prescribed by the Transport Infrastructure Act 1994 (Qld) as being 'to provide comprehensive transport services and services ancillary to those services, whether in or outside Queensland or Australia.'¹
11. QR operates Australia's largest rail network which is managed by QR Network Access and provides the following services: rail access, terminal access, asset management, asset maintenance and development, rail capacity management, train planning and network control, emergency response, and incident management and investigation.
12. QR provides services across four service lines:
 - freight transport and logistics for the coal, mineral and containerised product industries;
 - passenger transport for metropolitan commuters as well as long distance travellers;
 - provision of access to QR's rail infrastructure; and
 - consulting services to customers in Australia and overseas.
13. QR's freight business was recently re-branded as QR National.
14. QR operates a significant bulk line-haul business in Queensland and recently entered the New South Wales market with some bulk line-haulage in the Hunter Valley. The bulk carriage of coal and mineral products represents over 90 per cent of QR freight task by weight with QR being the largest carrier of coal in Australia.
15. QR also operates a general rail freight business within Queensland and between Queensland, New South Wales and Victoria. QR also provides some north-south containerised freight services.
16. QR offers passenger transport services throughout Queensland.

¹ Section 438(1) of the *Transport Infrastructure Act 1994* (Qld).

17. QR's rolling stock is almost entirely narrow gauge and following the electrification scheme in the 1980s a large proportion of its locomotives are electric. QR has 505 narrow gauge locomotives ranging from 2 to 40 years in age, and 10 694 narrow gauge wagons ranging from 2 to 40 years in age. QR also has a small number of standard gauge locomotives and wagons.
18. QR also operates the intermodal rail freight business within Queensland.
19. A summary of QR's areas of operation appears in table 1 below.

Table 1 – QR's operations

Location	Service
QLD	Provision of access to rail infrastructure
QLD and NSW	Bulk line-haul (coal, mineral, and containerised product industries)
Within QLD and between QLD, NSW and VIC	General freight
Within QLD	Metropolitan passenger transport (Citytrain) and long-distance passenger transport
Australia and overseas	Consulting services

Second acquirer (WA below rail assets): B&B

32. B&B is a global investment and advisory firm with investment activities focused on 'the creation, syndication and management of investment products for itself, as a principal, and its investor clients'. B&B's clients include wholesale investors such as multi-national financial institutions, charitable foundations, high net worth individuals and retail investors through publicly listed vehicles or financial products offered by B&B's retail distribution partners. One of B&B's key business groups is project finance and infrastructure including transport infrastructure.

The target: ARG

33. ARG is the third largest rail company in Australia following QR and Pacific National (PN).
34. ARG is the incumbent rail operator in Western Australia and South Australia and owns much of the Western Australian and South Australian track. The vast majority of ARG's operations are in Western Australia and South Australia.
35. ARG is a private rail freight operator. The company is a Western Australian based joint venture between Wesfarmers (a major Australian industrial organisation) and international rail operator Genessee & Wyoming (G&W). ARG's main businesses include:
 - rail haul logistics services in Western Australia, South Australia, New South Wales, Victoria and Northern Territory;

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- WestNet Rail, which provides track maintenance and access service to customers in Western Australia; and
 - track maintenance and access services to customers in South Australia.
36. Approximately 85 per cent of ARG’s business is transporting bulk commodities such as minerals and grains. Close to half of ARG’s revenue derives from ores and minerals and 30 per cent from grain.
 37. In South Australia, ARG provides interstate rail freight services for the haulage of bulk commodities including grain, iron ore and limestone. ARG also has a five year agreement to operate the OneSteel Whyalla Steelworks rail network in South Australia.
 38. ARG holds a 49 year lease (which began in 2000) over 5600km of standard and narrow gauge track in Western Australia. This track is subject to the Western Australia Rail Access Regime and the oversight of the Western Australian Economic Regulation Authority.
 39. ARG also has a 50 year lease (which began in 1997) over approximately 1300 km of rail track in South Australia. The track is also subject to the South Australian Rail Access Regime and the oversight of the Essential Services Commission South Australia.
 40. ARG also has an interest in the Australasia Railway Corporation which in October 2003 completed the construction of the rail line from Adelaide to Darwin. ARG also provides locomotives, wagons, crews and management services to the rail operator Freightlink.
 41. ARG has contracted with P&O Ports Limited to provide general freight haulage services between Melbourne and Adelaide. These services are generally used to transport freight originating in the Adelaide region to Melbourne for export and freight coming into Australia via the Melbourne Port to Adelaide and the surrounding regions.
 42. ARG also operates some trains from regional South Australia to Broken Hill in New South Wales, but carries less than 5 per cent of freight along this interstate route.
 43. ARG recently won a significant contract in New South Wales.
 44. ARG’s annual freight revenue is approximately \$350m.
 45. A summary of ARG’s areas of operations appears at Table 2 below.

Table 2 – ARG’s operations

Location	Service
NSW, NT, SA, VIC and WA	Rail haul logistics services
SA and WA	Track maintenance and provision of access to rail infrastructure

46. Table 3 below shows the composition of ARG's freight services for 2005.

Table 3 – Composition of ARG's freight services: 2005

Service	Wagon loads	Share of ARG's operations (%)
Iron Ore	19 337	23.1
Grain	19 202	22.9
Alumina	14 119	16.9
Bauxite	12 326	14.7
Other Ores & Minerals	8 576	10.3
Gypsum	2 969	3.6
Hook & Pull	1 093	1.3
Other	6 057	7.2
<i>Total</i>	<i>83681</i>	<i>100.0</i>

The proposed transaction

47. On 14 February 2006 the parties announced that they had reached an agreement for QR to acquire its above-rail assets (locomotives and rolling stock) outside of South Australia, and B&B to acquire the below-rail assets (track and associated assets)² in Western Australia as detailed in table 4, below:

Table 4 – Explanation of asset split

Component of ARG Business	Proposed owner		
	ARG ³	QR	B&B
SA above rail business (other than as set out below)	✓		
SA below rail infrastructure	✓		
WA above rail business		✓	
WA below rail infrastructure			✓
NSW contract (together with the rolling stock and supply contracts required to service that contract)		✓	
Adelaide/Melbourne contract (together with the rolling stock and other assets necessary to support the service)		✓	
Northern Territory APTC rolling stock services contract	✓		
Parkeston (WA) depot		✓	

48. On 16 February 2006 the ACCC commenced an assessment of the proposed acquisition under the ACCC's Guidelines for Informal Merger Reviews.

Timing

² Assets making up a rail network (including track works, signalling and other trackside systems, rail telecommunications systems, overhead electric traction equipment and marshalling yards).

³ It is proposed that ARG will be wholly owned by G&W, which currently owns 50% of the business and proposes to buy the other half from Wesfarmers. ARG will be renamed ASR.

Table 5: Timeline	
Date	Event
14 February 2006	The parties informed the ACCC that they were seeking informal clearance and would be making a submission to the ACCC.
16 February 2006	ACCC received submission from merger parties and commenced assessment.
10 March 2006	Market inquiries completed after extension granted to a number of parties.
30 March 2006	ACCC decision announced.

Areas of overlap

49. There is some overlap in the services and infrastructure supplied by the merger parties. However, there is minimal geographic overlap in their operations. Both QR and ARG provide rail line-haul services for the movement of bulk freight. There is also overlap in terms of the extensive holdings of both parties of narrow gauge rail assets used for bulk rail transport, as the states in which they operate run predominantly on narrow gauge lines.
50. As indicated above, QR operates bulk haulage services on the narrow gauge rail network in Queensland and provides some bulk line-haul in the Hunter Valley in New South Wales. It also operates a Brisbane – Melbourne containerised freight service.
51. ARG operates predominantly in Western Australia and South Australia, although it has one contract in New South Wales for the transport of grain and operates some relatively minor intermodal services between Adelaide and Sydney/Melbourne, and between Adelaide and Darwin.
52. QR and ARG’s businesses include the provision of other services (e.g. both provide access to rail infrastructure and QR provides passenger transport and rail consulting services).
53. An area of focus for the ACCC was the question of whether the provision of haulage services on narrow gauge networks in each other’s home states may be considered to be an area of potential overlap.

Market inquiries

54. The ACCC conducted market inquiries with a range of industry participants, including competitors, potential competitors, customers, suppliers, agencies with a role in regulation of rail assets, and other interested parties.

Effects of the proposed acquisition on competition in the market for non-bulk east-west rail line-haul services

Market definition

55. The ACCC considered that one of the relevant markets in this matter was the market for non-bulk east-west rail line-haul services. That is, a market for transporting goods by rail, predominantly in containers, between each of Victoria, New South Wales, the Australian Capital Territory, Queensland and South Australia (the Eastern States) and Perth. We refer to the geographic dimension of services to and from Perth as the east-west corridor.
56. Market inquiries indicated that rail line-haul services formed a separate market to other modes of transport on the east-west corridor. In particular, it was found that while some non-bulk freight is transported via truck, air, and sea, these modes of transport did not provide a significant competitive constraint on rail.
57. The ACCC closely examined issues involving non-bulk east-west rail line-haul services in the recent Toll Holdings / Patrick Corporation transaction. Although it should be emphasised that market definitions are determined separately for each proposed transaction, readers seeking more information about key factors in east-west rail line-haul services are directed to the ACCC's Public Competition Assessment of Toll Holdings' acquisition of Patrick Corporation.

Competition Analysis

Market concentration

58. Activities by QR and ARG in this market are extremely limited.
59. ARG runs 1-2 Sydney to Adelaide services per week. These services do not extend from the east coast to Perth. ARG also occasionally operates trains from Perth to Adelaide; however, these are ad hoc non-scheduled occurrences. P&O has commenced a Melbourne - Adelaide service utilising ARG and P&O's dock terminals.
60. QR had previously stated its intention to commence an east-west service, although market inquiries revealed differing views on how likely and how imminent this entry was in the absence of this acquisition.

Conclusion for market for rail line-haul services for non-bulk freight between the eastern states and Perth

61. Given the lack of overlap in the operations of the parties, as well as the constraint imposed by competition from PN and SCT on this route, and the lack of concerns about issues of vertical integration arising from this transaction, the ACCC considered that no substantial lessening of competition would arise in this market.

Effects of the proposed acquisition on competition in the national market for bulk freight tasks

Market definition

62. For much of Australia's rail haulage tasks, road is not competitive, particularly for mining products, which comprise two thirds of Australia's entire rail task.
63. Having regard to the scope of the proposed acquisition and the areas of overlap in the operations of the merger parties, the ACCC considered the relevant market as being comprised of the transport of bulk freight.
64. The ACCC assessed the likely competitive impacts on a national basis for bulk freight tasks, and notes that the same conclusion on competition would have been reached even if the same market were restricted to narrow gauge rail line-haul tasks only.
65. If a regional market definition were adopted, no overlap would arise in the operations of the merger parties in bulk freight tasks, and therefore no substantial lessening of competition would arise. It is therefore necessary only to consider whether a substantial lessening of competition would be likely to arise if a national market is adopted.
66. It should be noted the key determinant of whether national or regional markets are relevant for the purpose of competition analysis for bulk freight tasks will be the potential for supply side substitutability between rail providers based in different geographical locations. For convenience, this question of supply side substitution is considered in detail in the competition analysis below rather than in this market definition section.

Market characteristics

67. Market inquiries indicated that the merger parties and PN are by far the largest suppliers of bulk rail freight services. PN is the largest supplier of these services, followed by QR and ARG.

Competition Analysis

Market concentration

68. QR (Queensland) and ARG (South Australia and Western Australia) are the dominant players in their respective home states. PN holds the majority of contracts in New South Wales and Victoria.
69. ARG's rail haulage operations are predominantly bulk haulage in Western Australia and South Australia, with its main commodities being grain, iron ore, alumina, bauxite, gypsum, coal, nickel and mineral sands.
70. QR operates bulk haulage in Queensland as well as limited bulk haulage within New South Wales. In addition it operates a general freight business within Queensland (as well as between Queensland, New South Wales and Victoria).

Competition analysis

71. Market inquiries suggested that there was an increase in competitive tension around 2000 and shortly thereafter, following reform in the rail industry. This led to a large number of contracts being contested by at least two of PN, ARG, and QR.
72. However, since that time market inquiries suggest that each of the rail companies has found it extremely difficult to win contracts outside their areas of incumbency due to the very considerable cost and reliability advantages available to incumbents. Incumbent operators have invested large amounts in the capital necessary to service large contracts, have established skilled workforces in the relevant areas, and are able to spread costs across the many contracts they already hold in the state.
73. This is most clearly illustrated by the fact that, despite many attempts, QR has never won a bulk freight tender in WA and ARG has never won a bulk freight tender in Queensland.
74. Theoretically, the parties may constrain one another merely by providing a potential competitor to which a customer may turn. However, the ACCC considered that the complete lack of evidence of switching and other evidence gathered during market inquiries suggested that, in practice, competition between ARG and QR is very limited, and is likely to remain so in the future.
75. To the extent that tender processes impose a constraint on the merger parties, they will continue to do so via the presence of PN. There is also some evidence of overseas operators participating in recent tenders.

Countervailing power

76. QR and ARG submitted that bulk freight line-haul customers often have countervailing power and will continue to do so.
77. They submit that countervailing power of those customers is a product of three principal factors:
 - Economic size: Bulk haulage customers are some of the largest corporations operating in Australia;
 - Large contestable contracts: The short-term and long-term haulage contracts of large customers individually represent a significant percentage of the business of rail haulage operators and are contestable; and
 - Competitive tension: Customers may be able to leverage off the competitive tension created by effective access regimes and their access to capital. They may threaten to conduct bulk freight transport services in-house.
78. Market inquiries suggested that the ability of customers to exercise countervailing power is highly varied, with many small players appearing to have no real ability to provide their own bulk freight transport. However, the ACCC considers that some customers may enjoy a degree of countervailing power, particularly those in industries and/or states where there is evidence of actual shifts to in-house provision of bulk rail haulage.

79. For example, milling companies operate their own sugar cane rail lines in Queensland; Comalco operates its own bauxite railway system in northern Queensland; and BHP Billiton and Rio Tinto operate a private railway system for their Pilbara iron ore mining operations.
80. Any such countervailing power may be weakened or removed altogether if an effective access regime is not in place to allow companies to make a credible threat to provide their own bulk rail freight services.

Conclusion for the national market for bulk freight tasks

81. The ACCC formed the view that despite the concentrated nature of the market, no substantial lessening of competition is likely in this market. This was largely due to the relatively limited degree of competition between the merger parties now (due mainly to their geographic separation) and the fact that this was likely to continue to be the case.
82. Further, the merged entity will be constrained by the continuing competitive presence of PN. There may also be a constraint on the merged entity via countervailing power exercised by some customers and, to a lesser extent, the potential for entry of new market participants, which may be higher in this market than in other rail markets.

Effects of the proposed acquisition on competition in the market for short-haul non-bulk freight tasks in eastern Australia

Market definition

83. In previous rail industry matters, the ACCC has considered a market for short-haul non-bulk freight tasks. For many such tasks, both rail and road are price competitive.
84. Whether a rail freight task can be considered competitive with road may depend on their relative transit times, given the significance of this key service standard in the freight forwarding industry.
85. Road is generally not considered price competitive on longer routes and for large bulk commodities contracts.
86. Having regard to previous assessments and the results of market inquiries, the ACCC considers that the appropriate market definition is the market for short-haul non-bulk freight tasks, which is comprised mainly of non-bulk containerised freight transported over short to medium distances.

Competition Analysis

87. QR commenced operating containerised freight services between Melbourne, Sydney and Brisbane in April 2004. QR currently operates six services in both directions between Melbourne and Brisbane.

88. PN runs trains from:
- Melbourne to Sydney with up to seven return services per week;
 - Sydney to Brisbane with up to seven return services per week; and
 - Melbourne to Brisbane with up to ten return services per week.
89. As outlined previously, ARG's rail haulage operations are centred on bulk haulage in Western Australia and South Australia with its main commodities being grain, iron ore, alumina, bauxite, gypsum, coal, nickel and mineral sands. ARG's interstate containerised freight operations are limited to:
- Sydney to Parkes to Adelaide – one service per week, 20 to 30 containers per service; potential to add to this service is minimal as ARG has been unable to find improved terminal space in Sydney; and
 - Melbourne to Adelaide – six services per week, approximately 100 containers per service; potential to add capacity to this service depends on ARG being granted longer track access pathways by ARTC.
90. QR operates a general freight business within Queensland (as well as between Queensland, New South Wales and Victoria). ARG operates some narrow gauge non-bulk services, however the majority of its narrow gauge operations are for bulk freight.

Conclusion for market for short-haul non-bulk freight tasks in eastern Australia

91. Given the strong influence of road haulage providers and the low market shares of QR and especially ARG, as well as competition from PN, the ACCC considered that no substantial lessening of competition would arise in this market.
92. The ACCC notes that there are other short-haul freight tasks that may not strictly be part of this market. However, it is the ACCC's view that for these freight tasks, if road is price competitive with rail, the above analysis stands. Accordingly there will also be no substantial lessening of competition in relation to those tasks.

Effects of the proposed acquisition on competition in the market for access to below rail infrastructure in South Australia and Western Australia

Market definition

93. Below rail assets are those assets which make up the rail network including track works, signalling and other trackside systems, rail telecommunications systems, overhead traction equipment and marshalling yards.
94. ARG currently holds long term leases over rail track networks in Western Australia and South Australia, and QR owns and provides access to Queensland's rail infrastructure.

95. These rail track networks are subject to state access regimes. ARG is obliged to provide certain information to access seekers, and negotiate in good faith to provide track access to others. Queensland is required likewise to do so in relation to its below rail assets in Queensland.
96. The Commission considers that the relevant product market in this regard is access to below track infrastructure, with the relevant geographic dimensions being South Australia and Western Australia.

Competition Analysis

97. The acquirer of ARG's below rail assets in Western Australia, B&B, previously had no holding in this market, however broadly it is defined. The South Australian below rail assets are not being sold.

Conclusion for market for access to below rail infrastructure in South Australia and Western Australia

98. Given that this transaction involves a bare transfer of market share to a company with no holdings in this market, and it will lead to the disaggregation of ownership of above rail and below rail assets in Western Australia, the ACCC considered that no substantial lessening of competition would arise in this market.

Conclusion

99. The ACCC concluded that the proposed acquisition of certain assets from ARG by QR and B&B was unlikely to result in a substantial lessening of competition in any relevant market for the following reasons:
- In relation to the market for rail line-haul services for non-bulk freight between the eastern states and Perth: there is no overlap;
 - In relation to a regional or national market for bulk freight tasks: competition from PN, the potential for countervailing power to be exercised by some customers in some situations, and potentially relatively low barriers to entry compared with other rail markets;
 - In relation to the market for short-haul non-bulk freight tasks in eastern Australia: low market shares of QR and especially ARG, competition from road haulage providers and from PN; and
 - In relation to the markets for access to below rail infrastructure in South Australia and Western Australia: this is a bare transfer of market share to a new entrant.